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Message Text

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ACTION EB-07

INFO OCT-01 EUR-12 EA-07 IO-13 ISO-00 AID-05 CIAE-00
COME-00 FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02
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FM AMEMBASSY STOCKHOLM
TO SECSTATE WASHDC 9422
INFO AMEMBASSY ANKARA
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AMEMBASSY BONN
AMEMBASSY BRUSSELS
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AMEMBASSY OSLO
AMEMBASSY OTTAWA
AMEMBASSY PARIS
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E.O. 11652: N/A
TAGS: EFIN
SUBJECT: NEW FORECAST OF CURRENT ACCOUNT DEFICIT AND IMPLICATIONS

REF: (A) STOCKHOLM A-253, (B) STOCKHOLM A-246

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1. THE KONJUNKTUR INSTITUTE (SEMI-GOVERNMENTAL INSTITUTE FOR ECONOMIC ANALYSIS) HAS REVISED ITS ESTIMATE OF SWEDEN'S CURRENT ACCOUNT DEFICIT FOR 1976. THE INSTITUTE'S REPORT, DUE ON JANUARY 5, WILL PROJECT THE 1976 DEFICIT AT SK 9 BILLION ($2 BILLION). WE BELIEVE THIS TO BE THE LARGEST CURRENT ACCOUNT DEFICIT SINCE WWII, ALTHOUGH AVAILABLE DATA ONLY CONFIRM THIS AS FAR BACK AS 1961. INSTITUTE ALSO FORECASTS 1977 DEFICIT AT SK 9 BILLION LEVEL IN ABSENCE OF GOVERNMENT POLICY CHANGES.

2. REVISION IN FORECAST IS BASED ON RECENT EXPORT/IMPORT FIGURES WHICH INDICATE DEFICIT IN FOURTH QUARTER MAY EXCEED SK 1.6 BILLION. THIS WOULD YIELD A TRADE DEFICIT OF SK 2.5 BILLION ($600 MILLION) FOR 1976, AS OPPOSED TO LAST SPRING'S FORECAST OF SK 3 BILLION SURPLUS. THE SK 9 BILLION DEFICIT ASSUMES ALSO THAT SWEDEN'S SERVICES AND TRANSFERS ACCOUNTS HAVE NOT DETERIORATED FROM THE SK 6 BILLION PLUS ($1.5 BILLION) DEFICIT WHICH WAS FORECAST IN THE SPRING (SEE REFAIR B). WE EXPECT THIS ASSUMPTION WILL PROVE UNWARRANTED; THE TOTAL CURRENT ACCOUNT DEFICIT COULD THEN EASILY EXCEED SK 9 BILLION.

3. TRADE DEFICIT IS DUE TO CONTINUED STRONG GROWTH IN PRIVATE CONSUMPTION AND DERIVED DEMAND FOR IMPORTS. STRONG PRIVATE DEMAND HAS ALSO ADDED CONSIDERABLY TO DEFICIT IN SUCH ACCOUNTS AS TOURIST EXPENDITURES. AT THE SAME TIME, SLOWDOWN IN ECONOMIC RECOVERY AMONG INDUSTRIALIZED OECD COUNTRIES HAS LED TO DISAPPOINTING GROWTH IN DEMAND FOR

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SWEDISH EXPORTS. RAPIDLY RISING EXPORTS TO OPEC COUNTRIES HAVE COME NOWHERE NEAR OFFSETTING RISE IN SWEDEN'S OIL BILL. ESCALATION OF LABOR COSTS IN SWEDEN HAS ALSO FORCED PRICES OF EXPORTS UP (15 PERCENT MORE THAN THE AVERAGE OF WORLD EXPORT PRICES IN THE LAST TWO YEARS, ACCORDING TO THE INSTITUTE.) (SEE REFAIR B FOR ESTIMATE OF SWEDEN'S LOSS OF MARKET SHARES IN OECD). THE FULL IMPACT OF EXPORT PRICE RISES HAS PROBABLY NOT YET BEEN FELT, ACCORDING TO THE INSTITUTE, SO THE PICTURE FOR 1977 BECOMES BLEAKER THAN THESE FIGURES MIGHT INDICATE.

4. THE NEW GOVERNMENT IS NOW COMING TO THE POINT WHERE DIFFICULT AND UNPOPULAR DECISIONS MUST BE MADE. GENEROUS UNEMPLOYMENT BENEFITS, RETRAINING PROGRAMS, INVENTORY SUBSIDIES, AND OTHER COUNTER CYCLICAL POLICIES GREATLY REDUCED THE IMPACT OF THE RECENT WORLD-WIDE RECESSION IN SWEDEN. REAL GROWTH OF GDP WAS 4 PERCENT IN 1974, 1 PERCENT IN 1975 AND WILL PROBABLY BE AROUND

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1.5 PERCENT THIS YEAR. UNEMPLOYMENT WAS HELD DOWN TO
1.5 PERCENT OF THE LABOR FORCE. THESE RESULTS WERE
ACHIEVED AT THE EXPENSE OF RISING DEFICITS ON CURRENT
ACCOUNTS AND FINANCED BY FOREIGN BORROWING. ANOTHER
EXPENSE HAS BEEN CONTINUED PRICE PRESSURE IN THE
DOMESTIC MARKET. THIS SITUATION CANNOT CONTINUE
INDEFINITELY.

5. ARRIVING AT THE APPROPRIATE POLICY MIX IS GOING
TO BE QUITE DIFFICULT, HOWEVER. PRESCRIPTIONS FOR ACTION
VARY FROM A REDUCTION IN VALUE ADDED TAX TO PREVENT
A RECESSION, TO AN INCREASE IN THE VAT TO DAMPEN
DEMAND AND REDUCE IMPORTS. ALTHOUGH DEVALUATION IS
MENTIONED OFTEN, IT DOES NOT APPEAR TO HAVE REALLY
STRONG SUPPORT, EVEN AMONG EXPORTERS WHO MIGHT STAND TO
BENEFIT. WHILE THE GOVERNMENT WRESTLES WITH THE VARIOUS
ALTERNATIVES, ALL-IMPORTANT NATION-WIDE NEGOTIATIONS ARE
NOW UNDERWAY BETWEEN LABOR AND MANAGEMENT.
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6. ALTHOUGH MINISTER OF FINANCE BOHMAN EARLIER MENTIONED
THE POSSIBILITY OF AN INCREASE IN VAT, AND OTHERS ARE ON
RECORD OPPOSING DEVALUATION, WE DO NOT NOW HAVE HARD
INFORMATION ON THE GOVERNMENT'S INTENTIONS. BUDGET
MINISTER MUNDEBO DID TELL EMBOFF RECENTLY THAT HE WAS
HAVING GREAT DIFFICULTY FINDING A WAY TO COVER A
DEFICIT OF SK 10 BILLION IN THE FORTHCOMING BUDGET. WE
HAD PREVIOUSLY UNDERSTOOD THE DEFICIT TO BE AS HIGH AS
SK 18 BILLION, BUT EVEN THE LOWER FIGURE INDICATES THAT
FISCAL POLICY IS STILL RELATIVELY EXPANSIONARY. THE
INSTITUTES'S REPORT SHOULD ACT AS A USEFUL STIMULUS TO
THE GOVERNMENT, AND MAY ALSO BE HELPFUL TO EMPLOYERS
IN THEIR EFFORTS TO HOLD DOWN WAGE INCREASES.

7. IMPLICATION FOR THE US IS THAT SWEDEN WILL ALMOST
CERTAINLY BE MORE VOCAL THAN BEFORE IN URGING
EXPANSIONARY POLICIES BY US, GERMANY AND JAPAN, PER
RECENT OECD MEETINGS. WE DO NOT ANTICIPATE ACTION WHICH
WOULD RESTRICT IMPORTS, NOR DO WE BELIEVE ANY MACRO-
ECONOMIC POLICY WILL BE SUFFICIENTLY STRINGENT TO DAMAGE
US EXPORT PROSPECTS MORE THAN MARGINALLY.
SMITH

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